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COMMENTS:

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November 5, 1997

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Exxon Company, U.S.A. Comments for Establishing Oil Value for Production on Federal Leases, 62 FR 49460 (September 22, 1997)

Dear Mr. Guzy:

Exxon welcomes this opportunity to submit written comments on the alternatives published at 62 FR 49460 (September 22, 1997). Comments based on the discussion of these alternatives at the September 30-October 1 (Denver) and October 7-8 & 14 (Houston) workshops are also included. These comments are supplementary to the previous comments filed by Exxon on the January 24, 1997 proposal and the July 3, 1997 supplemental proposal.

Consideration by the Minerals Management Service (MMS) of alternatives other than the widely criticized January 24, 1997 proposed Oil Valuation Rule could be a very positive step. The alternatives being considered, however, are presented in a very abstract manner and need greater detail to allow a more thorough review. Therefore, these comments will address only in a general sense Exxon's preliminary views on the alternatives.

OVERRIDING OBJECTIVE

The overriding objective in the consideration of proposed rule or alternative should be to provide a certain and simple method of valuing crude oil and condensate sale produced at federal leases. The workshop discussions where the MMS suggested variations by region and by the company structure (integrated refiners versus non-refiner affiliates) are unacceptable. If this were to occur, the complexity of the alternatives would add many more costs, in terms of systems, audits, and administrative time, for both the MMS and the royalty payors. Methods such as these will also raise certain legal issues as to discrimination that could lead to litigation and further costs. Any proposed rule should address valuation in a consistent manner across the nation without discrimination and without additional costs to either the MMS or its lessee/payor.

Though not discussed here at the request of the MMS, the goals of certainty and simplicity could be met with a workable RIK program.

ALTERNATIVES

The three alternatives on benchmarks, differentials, and index methods that have been proposed by the MMS and discussed in the workshops are discussed below:

1. Benchmarks

The MMS has proposed a series of benchmarks for valuing production not sold under arm's length contracts. Because the MMS has left many critical issues unaddressed, it is difficult to address these alternatives meaningfully. As discussed in Exxon's earlier comments, the MMS need not throw out the existing benchmarks.

The first benchmark that MMS proposed is a bidding out or tendering program for valuing production not sold under arm's length contracts. Exxon is willing to consider such a program. However, many details must be addressed. The amount of total production to be bid out in order to establish a royalty value should be a reasonable percentage of production and not an extraordinary percentage of production as mentioned by some federal and state representatives. Any minimal volume requirement greater than the royalty share should be carefully scrutinized. If large volumes were required in a tendering program, such a restriction would unreasonably restrict the use of this benchmark and inappropriately disrupt commercial and logistical efficiencies.

The second benchmark proposes using the lessee's purchases at the lease. Exxon believes that arms'-length sales of production that are not part of a formal tendering program could also be considered. The MMS has articulated no rationale for exclusion of such sales. As with tendering, requiring unreasonably large percentages of production to be purchased or sold outright would restrict the use of this benchmark.

The third benchmark providing for valuation based on outright sales by third parties does not seem to be sufficiently detailed for comment. How would this information be obtained? Would the MMS publish this data? If so, how up to date would the data be kept? How could a producer challenge an assessment if it is based on third party proprietary contract information?

The fourth benchmark, use of MMS's royalty in kind sales as a benchmark for value, needs substantially more detail. Using RIK to set values presents many issues to be addressed such as would the RIK comparable sales be at the lease or would they require quality differentials and a netback for a valid comparison?

The fifth benchmark, a netback method using price information from the nearest market center or aggregation point, appears to be only a minor variation from the original proposal. The problems associated with this method are addressed in Exxon's, other companies' and trade associations' comments on the original proposal and have not yet been addressed by the MMS.

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For all of the benchmarks outlined, the appropriate transportation and other deductions allowed under the lease must be provided for. For the third, fourth, and fifth benchmarks, the overall objective of simplicity is not apparent.

2. Differentials

The fourth alternative utilizes fixed differentials to attempt to arrive at the market value at the lease for different crude oils. This point has been extensively discussed in the aforementioned comments. The comments are applicable when considering any fixed cents per barrel or mileage based type deductions which do not fairly capture crude oil quality and location variances.

3. Index

The index method outlined appears to be only a minor variation from the original proposal. Please refer to Exxon's comments to the original proposal for greater detail on the problems associated with an indexing methodology.

REGIONAL METHODS

The MMS has asked in the published alternatives and in the workshops whether the benchmark alternatives should apply only to the Rocky Mountain region, ANS prices be used as the basis for California, and NYMEX prices be used as the basis for the other regions including the Outer Continental Shelf (OCS). Exxon disagrees. A valuation methodology utilizing tendering or outright purchases or sales of a reasonable percentage of production could potentially provide a workable, certain, and simple method for valuing MMS production in any location, including California.

CALIFORNIA

The various representatives of the State of California asserted in each workshop that ANS was the only method for royalty valuation of California crude oil. In Exxon's original comments on the proposed oil valuation rule, Exxon outlined its disagreement with the ANS proposal and described why this methodology does not reflect California crude values. There has been no substantive response by the MMS on these issues to date.

CONCLUSION

Exxon urges the MMS to consider valuation alternatives including a workable RIK program that meet the overall objectives of simplicity and certainly for valuing federal lease crude oil. We reiterate that having regional or lessee-specific methods is not a solution. The inherent problems contemplated by some of the valuation proposals will create greater administrative overhead for the MMS, States, and lessee/payors.

Rebecca D. Langley